No. 15250

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

THOMAS F. DORAN, ETHEL M. DORAN, ONEY S. RIGGS, DOROTHY F. RIGGS, IDA BEE MacDONALD, CLARA NIEMAN, GUS H. NIEMAN, JOHN W. MacDONALD, *Petitioners*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

No. 15250

REPLY BRIEF OF APPELLANTS (PETITIONERS)

On Appeal from the Tax Court of the United States

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The briefs filed in this case draw the issue very sharply. The facts were stipulated and the issues are pure issues of law—corporation law and trust law. Since there is no question of fact involved—only issues of law—the decision of the Tax Court is not controlling.

Owen vs. Commissioner (CA - 9) 53 F. 2nd 329

It must be conceded that there was a corporation distribution in connection with the transaction involved in this case. If the distribution was made when the insurance policies were taken out and the premiums paid, then, as respondent inferentially concedes, the decision of the Tax Court should be reversed since there could not be two distributions of the same property. If there was no distribution until the policies matured and were used for the purpose of funding the stockholders' buy-sell agreement, then the decision of the Tax Court should be affirmed. The issue turns on who were the beneficiaries of the trust set up by the stockholders' agreement of July 10, 1943.

It was somewhat surprising to find Respondent taking the position that there was no distribution of corporate assets when the corporation paid the premiums on the insurance policies. (Br. 11, 17) Respondent does not even mention the case of *Paramount-Richards Theaters, Inc., et al vs. Commissioner* (CA 5) 153 F. 2d 602. It is difficult to believe that had not fate intervened to mature one of these policies, and had the tax authorities audited the books of this corporation before any of the parties died, that a deficiency would not have been assessed against each of the individuals who were parties to the agreement of July 10,

1943, based on the amount of premiums paid on these policies.

Respondent agrees in principal that the substance, not the form, of the transaction should control. (Br. 18) However, Respondent proceeds to base its entire argument on what was said rather than on what was done. It relies entirely on the wording of the resolutions and the application. It has already been conceded that the parties to this transaction did not have a clear concept of what they were trying to do and it is also obvious that they had no clear idea of the difference between the acts of a corporation as an entity and the acts of the stockholders as individuals. The persons who might have known the actual intent of the parties, Mr. Ealy and Mr. Brown, both died before trial. (R. 20) They apparently realized that the policies should not be issued in the name of the corporation and that the corporation should not execute—should not even be a nominal party to—the Agreement of July 10, 1943. Respondent ignores these latter facts and, more important, ignores the basic fact that this transaction did not and could not benefit the corporation as such but could only benefit the stockholders.

Respondent advances a theory that because the ultimate beneficiaries of this agreement could not be ascertained until an insured officer died, there was no present interest in the policy which could be held by the individual stockholders at the time of the issuance of the policy or when the premiums were paid. It then goes on to state that no trust can be created in the proceeds of a policy because "an interest which has not come into existance cannot be held in trust." (Br. 17, 18) If Respondent means to contend that

the beneficiaries of a trust must be definitely ascertained at the time of its creation, its position is contrary to well established law. It is only necessary that the beneficiaries be definitely ascertainable within the period of the rule against perpetuities.

1 *Restatement of the Law of Trusts* 288 (Sec. 112)

2 *Scott on Trusts,* 2d ed., 807, (Sec. 112)

If Respondent means to contend that the rights of a beneficiary of an insurance policy may not be held in trust, the law appears to be settled to the contrary.

1 *Restatement of the Law of Trusts* 241 (Sec. 84, Com. b)

1 *Scott on Trusts,* 2d ed., 637, 638, 646, 647 (Sec. 82.1, 84.1)

As said by Professor Scott at page 647, referring to the same argument made here by the respondent, "The courts, however, have had no difficulty in rejecting these arguments." A beneficiary's interest in an insurance policy has so long and consistently been regarded as a present property right that further citation of authority should not be necessary. Respondent's citations, *Restatement of the Law of Trusts,* Sec. 75 and *Brainard vs. Commissioner,* 91 F. 2d 880 (CA 7th) are not in point.

The trust was set up for the benefit of the stockholders of the corporation. The fact that a stockholder would, upon sale of his stock, automatically transfer his rights as a beneficiary and, incidentally, would transfer his obligation to the other stockholders under the buy-sell agreement, would not affect the validity of any trust agreement that might be

made among the stockholders. The beneficiaries would clearly be ascertainable within the period of the rule against perpetuities.

Respondent claims that this transaction is only a variation of the common stock purchase plans and in legal effect is the same as that used in *Cummings vs. Commissioner*, 73 F. 2d. 477 (CA 1st). (Br. 19) So far as we are aware, there are two kinds of standard stock purchase plans. One, where the corporation buys the insurance, is the beneficiary and uses the proceeds to purchase and possibly retire the stock of the decedent. Second, where the stockholders take out insurance on each other's lives and use the proceeds to purchase the decedent's stock on their own behalf. The *Cummings* case was the first type except that instead of using the proceeds to purchase the stock, the stockholders agreed that they would cause the corporation to distribute the proceeds as a dividend. The proceeds actually went to the corporation and became a part of the assets of the corporation, subject to the debts of the corporation and subject to all restrictions on the declaration of dividends.

The instant case is more closely related to the second type of plan. The proceeds were received by trustees appointed by the stockholders and even though the corporation may have instructed the stockholders to do so, the stockholders were still not acting as agents for the corporation, as Respondent implies. They were acting solely for their own benefit. If an employer tells a man to go out and have dinner the man does not act on behalf of or as agent for his employer when he follows the employer's advise. The trustees had, and knew they had, only one obligation to ful-

fill with respect to the handling of the proceeds of the policy—to use them for the benefit of the stockholders in connection with their buy and sell agreement.

It is respectfully submitted, that since the stockholders made the trust agreement—and without the participation of the corporation—and since the stockholders were the sole beneficiaries under the terms of the trust agreement, the stockholders, not the corporation, were entitled to the proceeds of the insurance policy. The determination by the Tax Court that the corporation received the proceeds and distributed them to the stockholders as a special dividend was error and the decision of the Tax Court should be reversed.

Respectfully submitted,

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